

Michigan Economic and State Budget Update and Long-Term Outlook

**Presented to
Michigan Community College Association**

**March 26, 2010
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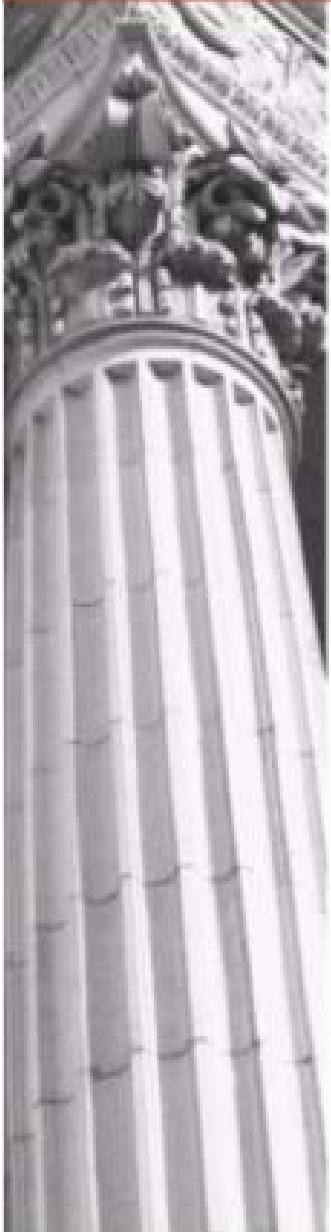
Citizens Research Council

- Founded in 1916
- Statewide
- Non-partisan
- Private not-for-profit
- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
- Relies on charitable contributions of Michigan foundations, businesses, and individuals
- *www.crcmich.org*



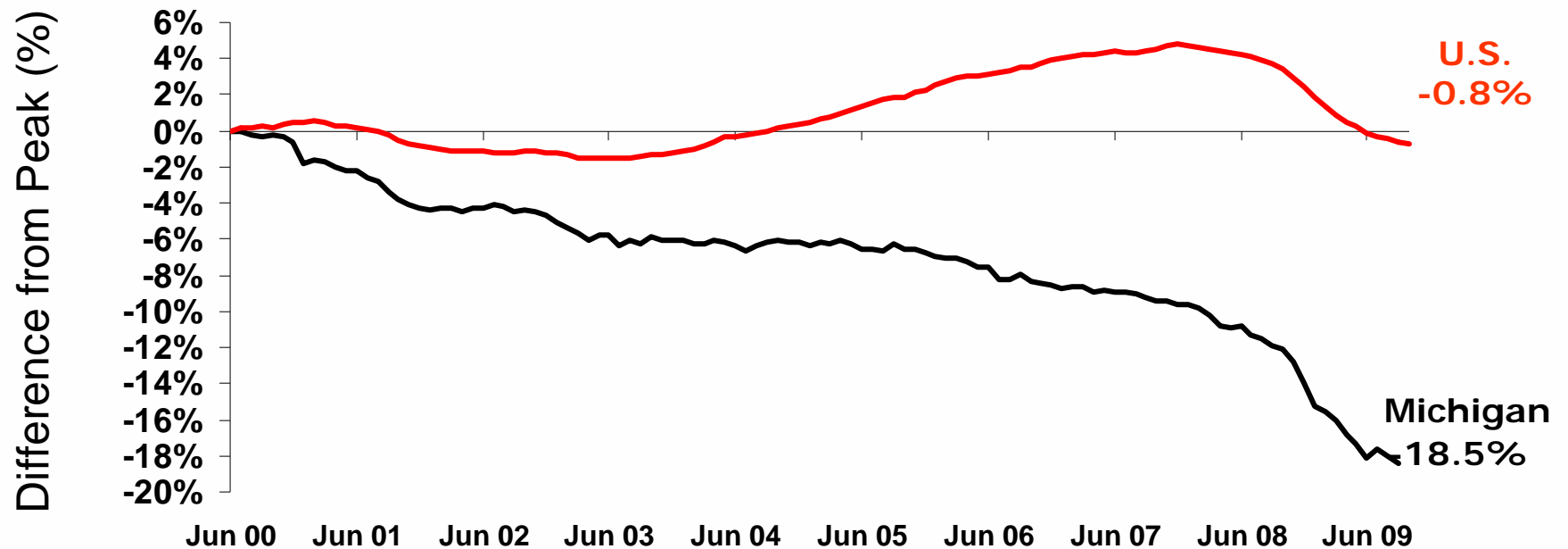
What is the State of the Economy?

- U.S. recession probably ended over the summer, but employment growth still several months off
- Michigan employment growth will trail U.S., but we could see growth towards the end of next year
- Recovery is tenuous, especially in MI and will take time
- It could have been worse, we did not enter a depression, and Ford, GM, and Chrysler are still here





Michigan Has Now Lost 1 in 6 Jobs (with 35% of loss in last 12 months)

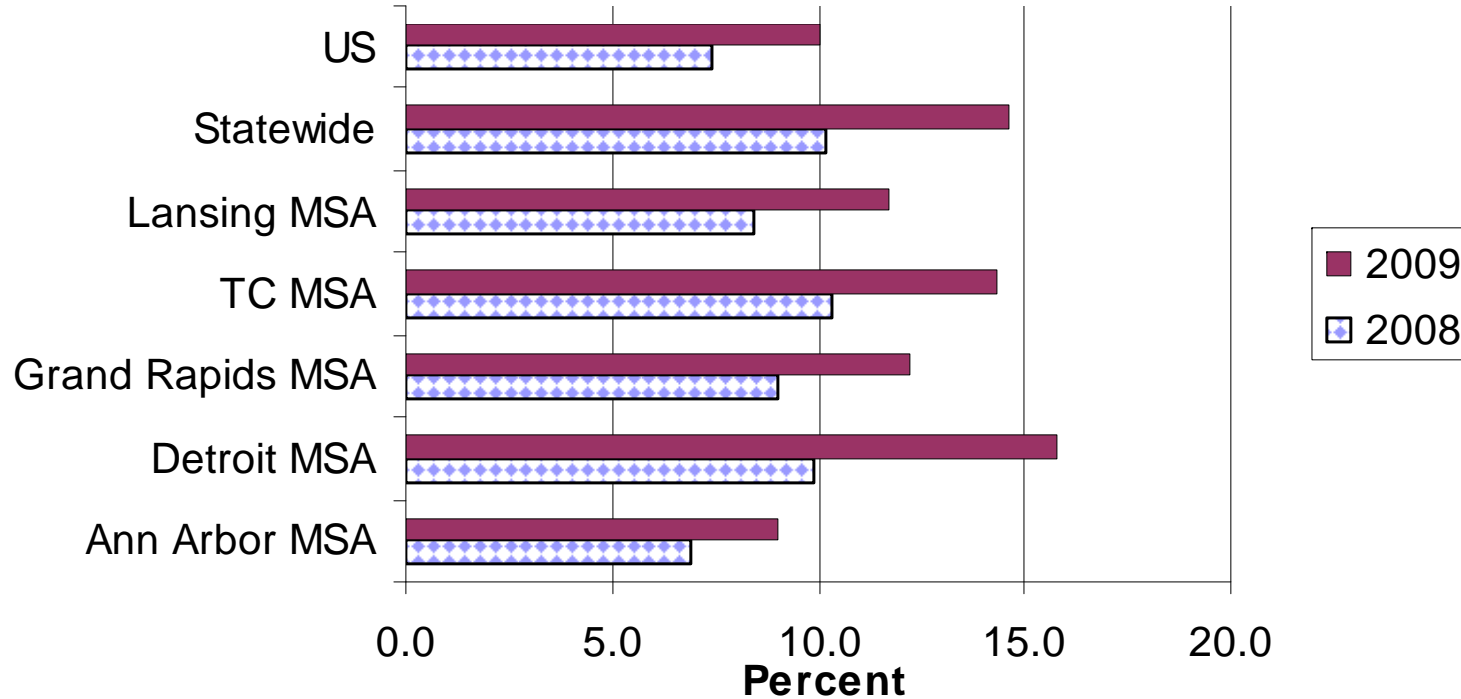


- 4 Note: Peak is calculated from Michigan's June 2000 Peak. Data through August 2009.
Source: Bureau of Labor Statistics



Unemployment Still Very High

Unemployment Rates: Dec. 08 and Dec. 09

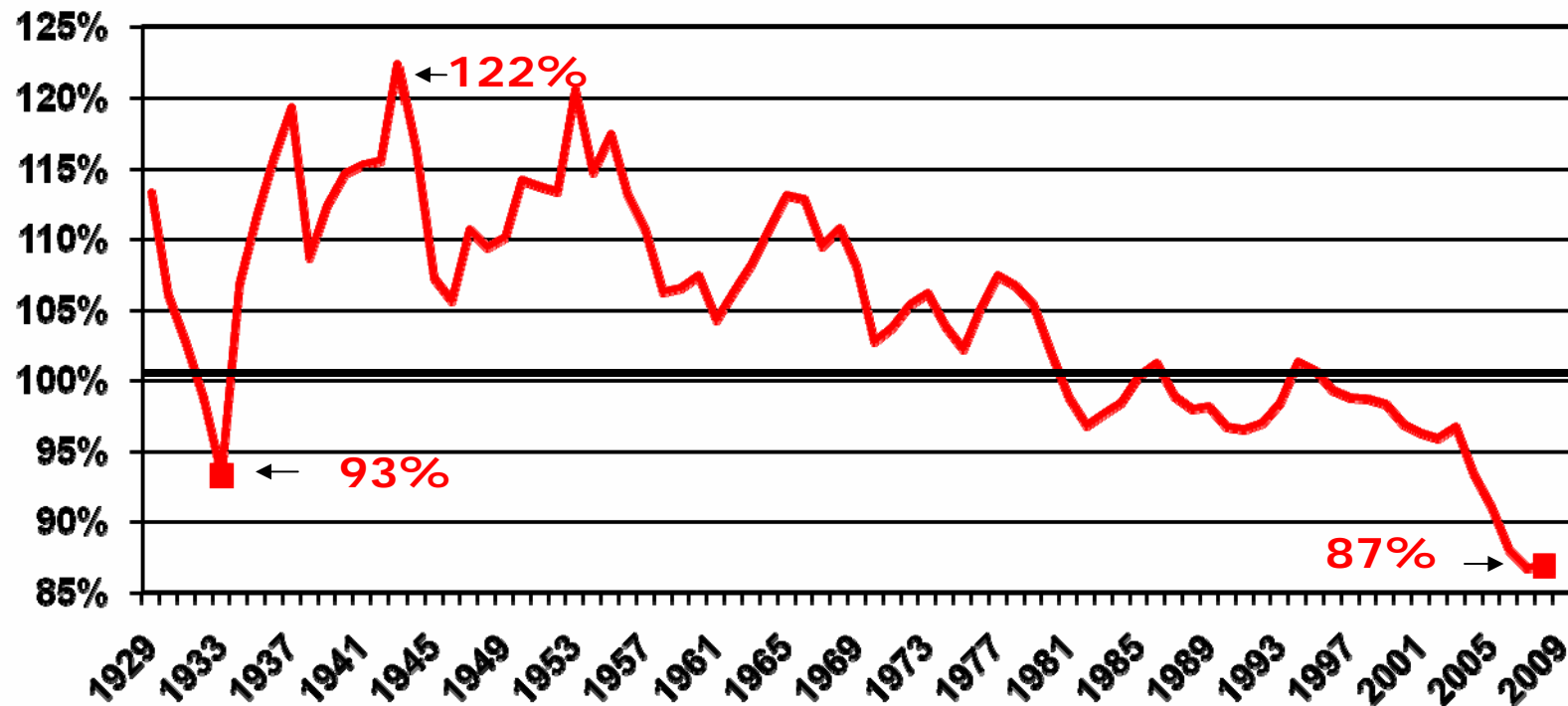


source: Bureau of Labor Statistics. US, MI, and Detroit - seasonally adjusted. Lansing, Grand Rapids, Ann Arbor not seasonally adjusted



Michigan Personal Income Falling Relative to U.S.

Michigan per Capita Income as a Percent of U.S. Per Capita Income

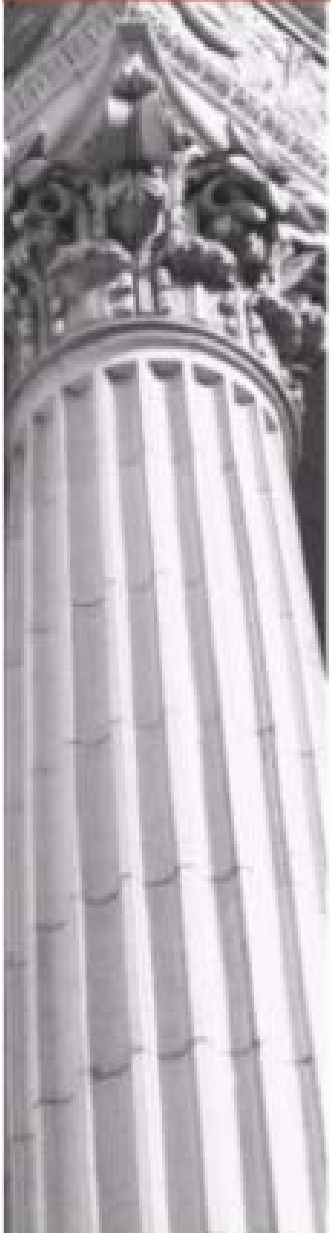


Source: CRC calculations from Bureau of Economic Analysis data. March 24, 2009 personal income release for years Prior to 1969. October 16th release for years after 1969.



The Michigan Budget Story Has Not Changed . .

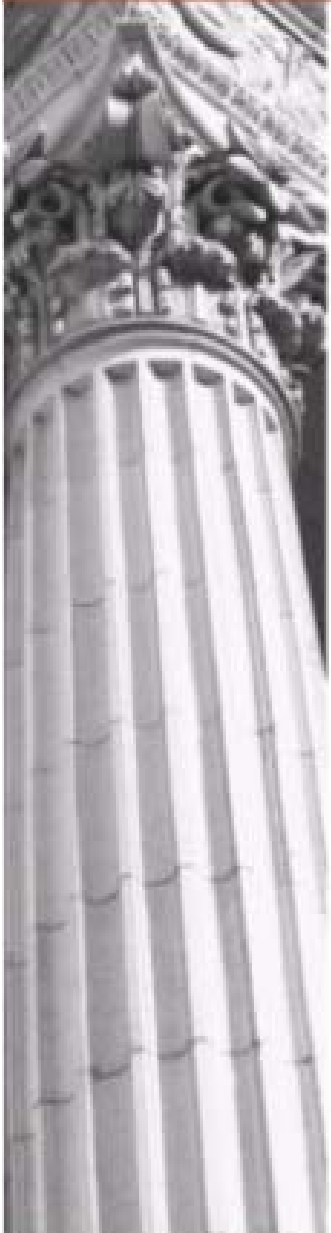
- The State of Michigan continues to face dual structural deficits affecting:
 - Public K-12 education
 - General Fund-financed programs
- Its causes have both spending and revenue components
- We will **not** grow out of it
- Conclusion: Significant spending cuts and/or tax increases will be required to align on-going spending and revenues





But There is a New Chapter

- Severe recession: all of '08 and most of '09
 - Consumption
 - Business spending
 - Homebuilding
- Impacts on state budget were massive
 - Revenue declines unprecedented
 - Spending demands spiked
- State budget unprepared to deal with current recession
 - Exhausted reserves
 - Tax increases of 2007
- Must correct for two problems simultaneously
 - Structural deficits
 - Cyclical deficits
 - Each problem requires specific set of tools





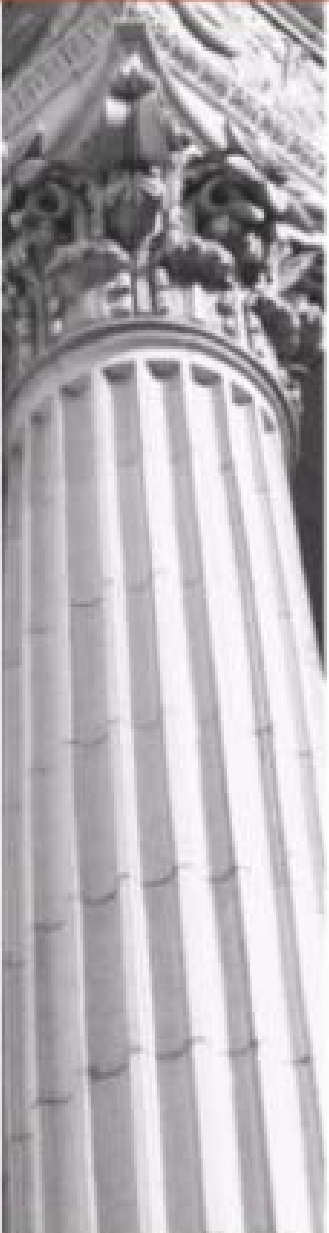
Deficits Defined

Cyclical — Caused by economic downturn

- Revenues worsen
- Some spending pressures increase
- Deficit erased when economy recovers, over time (self-correcting)
- Interim, use extraordinary measures to achieve budget balance

Structural — Caused by spending pressures outpacing revenue growth

- Spending to maintain current policies and programs
- Revenue insufficient, even in good economic times
- Unable to grow out of this type of deficit





FY2009 and FY2010 Budgets *Attention to Short-Term Problem*

- Revenue decline in FY2009: -21%
 - Major taxes affected by economy
 - Tax policy changes contributed too
 - After 13% increase in FY2008 (income tax rate increase)
 - Overall: \$2 billion hit to General Fund
- Another 6% decline in FY2010
 - Economy and tax policy factors continue
 - Another \$500 million

Two-year decline: \$2.5 billion





Recent Solutions

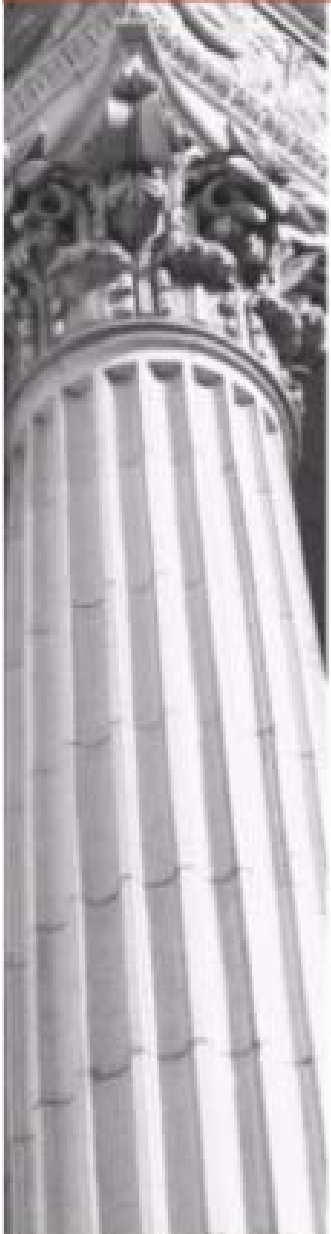
A Tale of Two Approaches

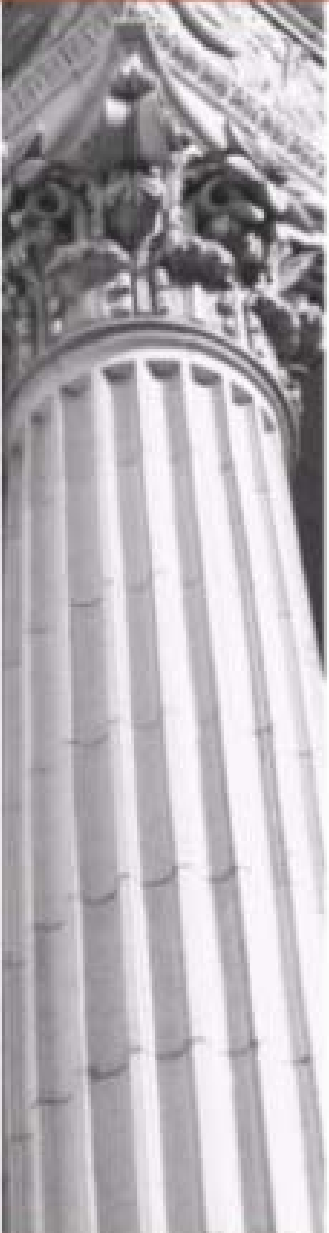
FY2009: \$1.4 Billion Shortfall

- Late in fiscal year – options limited
- Mix: about 1/3 cuts and 2/3 “stimulus”
- Push major portions of problem to FY2010

FY2010: Another \$1 Billion Deficit

- More attention to reductions
- Stimulus funding protected some areas, but cuts still widespread
- Overall reductions of \$850 million





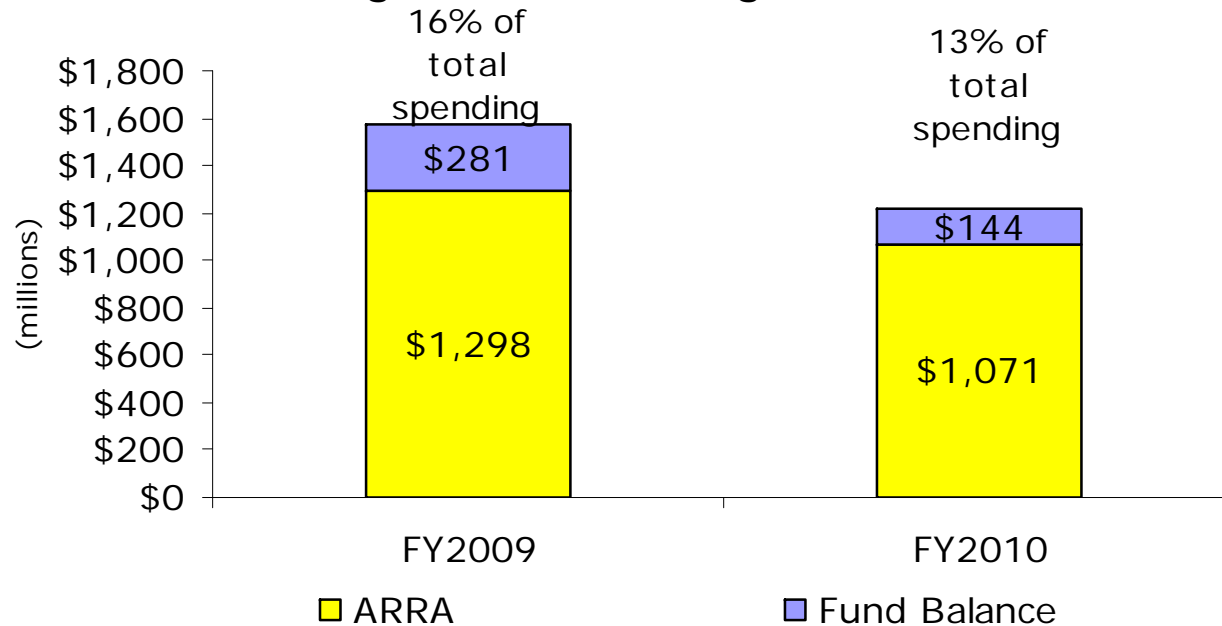
FY2010 GF Cuts Widespread

- Medicaid provider rates (8% from original FY2009 level)
- Non-Medicaid CMH funding (\$40M cut)
- Elimination of \$238M from DHS budget
- Assistance to local governments (19% reduction from FY2009 level)
- Scholarships to university students (elimination of Promise Grants)
- State employee concessions/layoffs (varied)
- Average of -8.4% cut (GF-GP) across all state departments
 - Some larger than others
 - Some areas protected from cuts per ARRA



Budget "Balance" Achieved *Heavy Reliance on One-Timers*

GF/GP Budget: Non-Recurring Resources Used



* Based on Governor's FY2011 executive budget

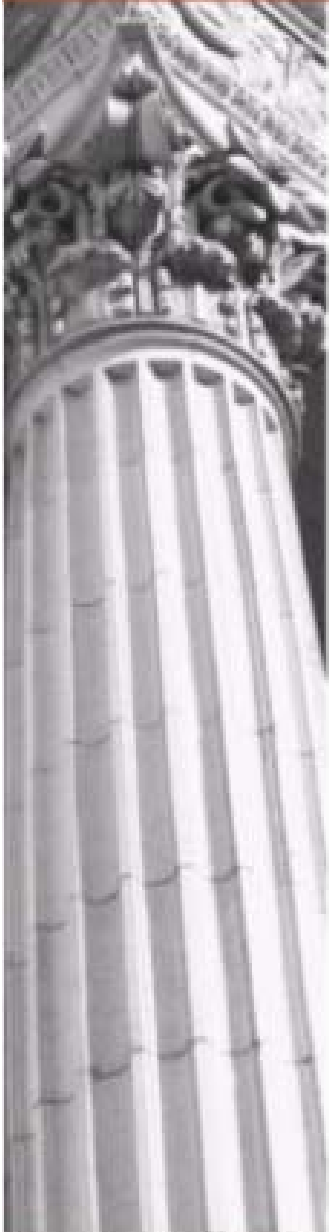
Fund Balance = \$458 million at 10/1/08



Michigan's Fiscal Future

Why Perform the Analysis?

- Projections of state revenues and spending seldom made beyond the current budget year
- Failure to estimate the future consequences of current actions leads to unpleasant surprises
- Knowing where we are headed helps justify actions to change the future

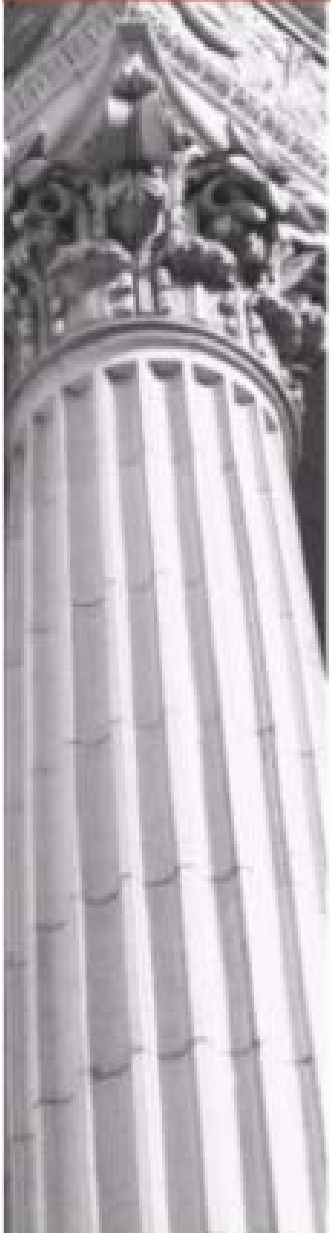




Observations About 2001 to 2008

Structural Changes Largely Avoided

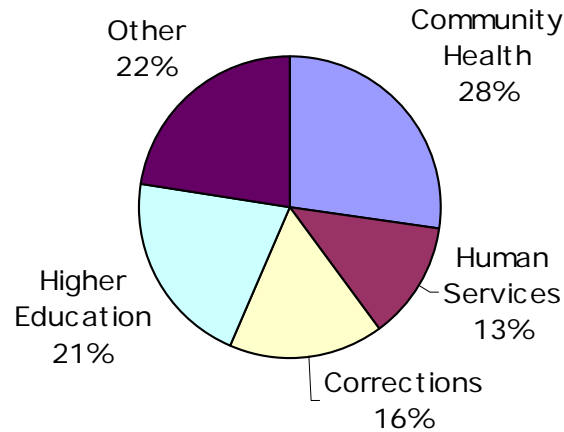
- 7 years of spending cuts – transform budget
- Major tax cuts since late 1990s
- \$8 billion in one-time resources used including reserves to achieve balance
- Cash position improved with 2007 tax increases, but still very tenuous
- Weakened connection between revenue structure and the economy
- Budget concentrated in 4 primary areas
 - Spending pressures growing faster than revenues





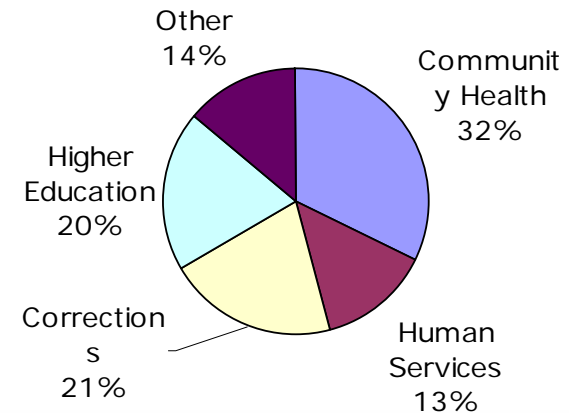
Michigan's General Fund Budget *Significant Changes*

General Fund Spending-2001



Total: \$9.9 Billion

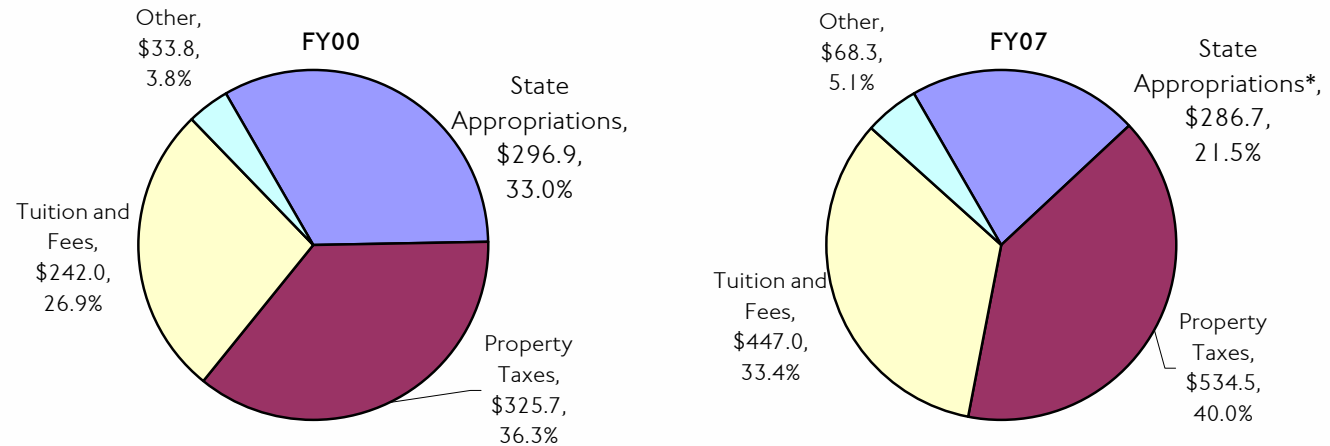
General Fund Spending-2008



Total: \$9.2 Billion



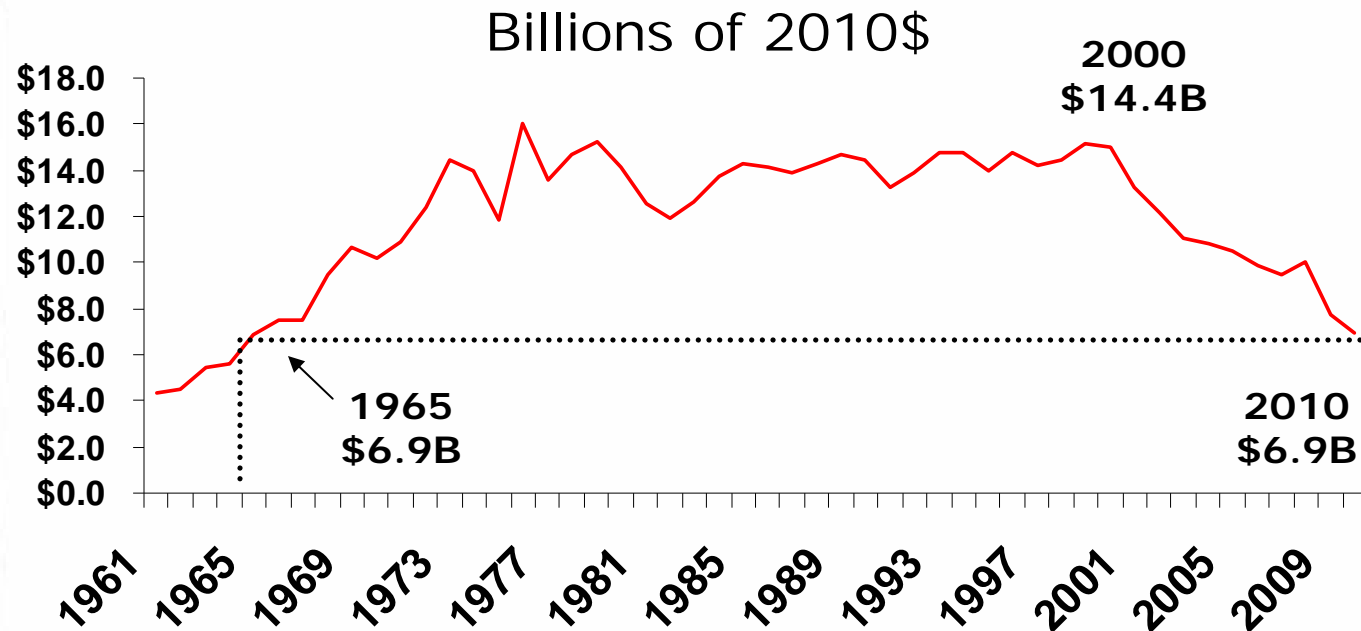
CC Finances Noticeably Affected *State Share Dropped*



Source: ACS Data Book, Michigan DLEG.



Michigan's Discretionary Revenue *GF/GP at 1965 and one-half of 2000*



Note: GF-GP figures are presented on a Consensus basis and adjusted for inflation to 2010 dollars using the state and local government price deflator. 2009 and 2010 are estimates.



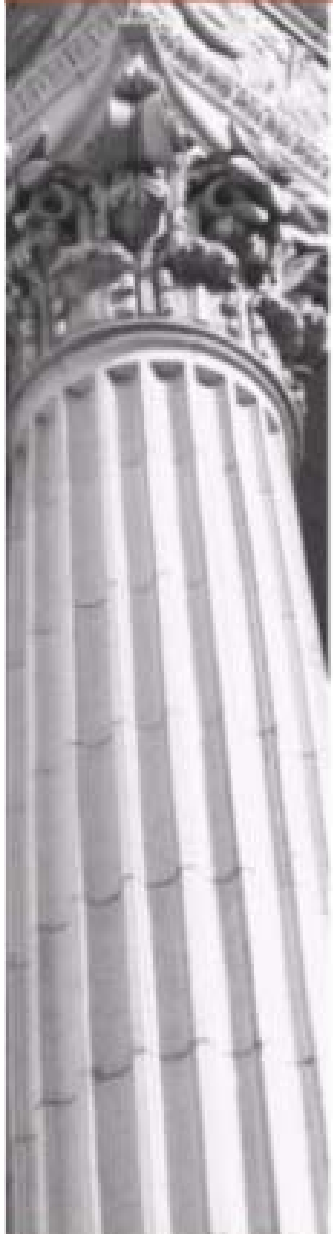
The Analysis Begins With The Economy

Annual rates of change

- Total Employment (-.07%)
- Labor Force (-.25%)
- Real Gross State Product (+1.2%)
- Labor productivity (+1.6%)
- Personal Income (+4.2%)
- Payrolls (+3.8%)
- Population (-.04%)

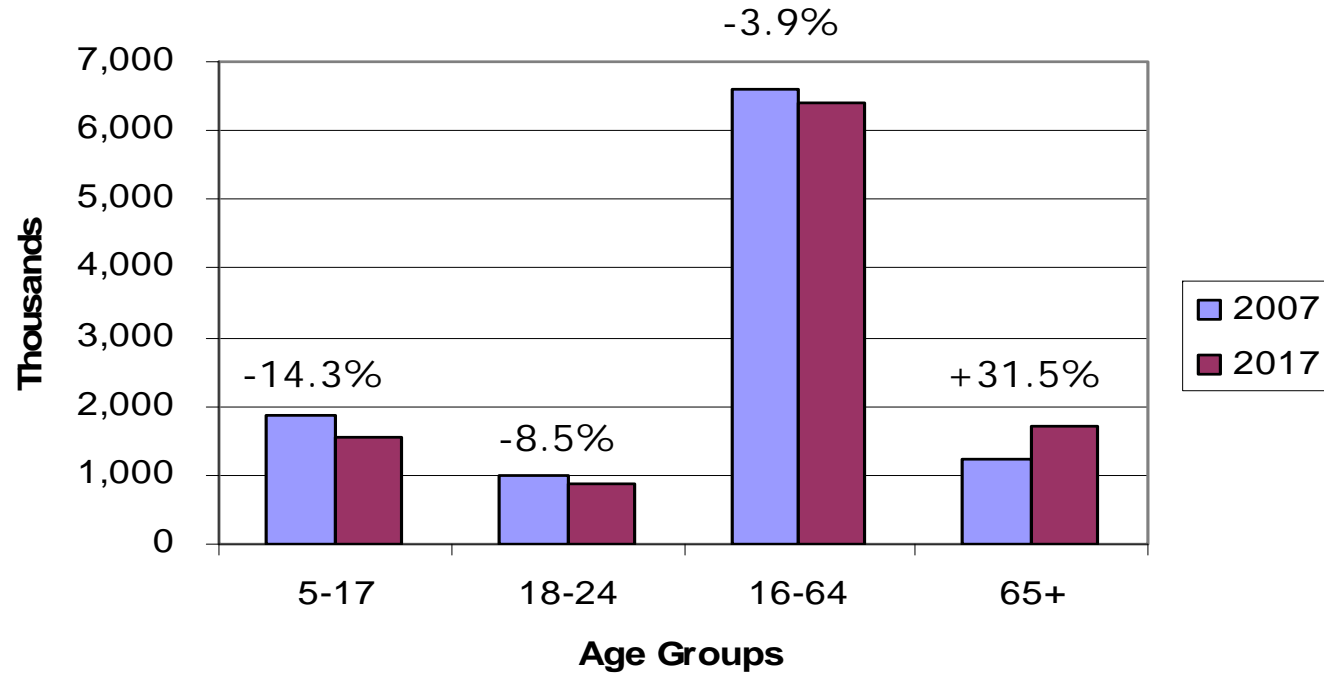
Overall a moderately improving economy





Spill-Over Effect

Continuation of Demographic Shift

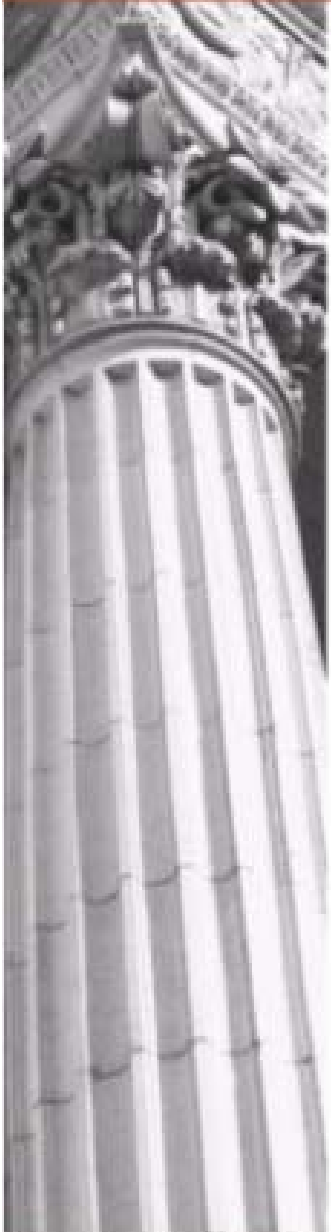


Source: CRC, *Michigan's Fiscal Future*



Growth Rates in Major Taxes (FY2009-FY2017) The Capacity to Fund Spending

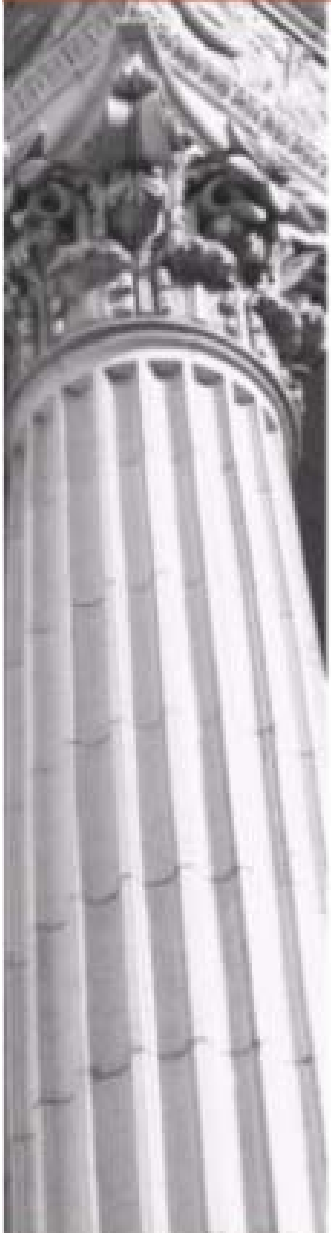
- Income—3.25%
- Business—3%
- Sales—3%
- Use—3%
- Tobacco—Minus 2.5%
- State Education (Property)—4.5%
- Other Sources—1.8%





GF-GP Revenue Growth FY2009-FY2017

- Without any tax cuts, growth rate is 3% per year
- Tax cuts already in state law
 - Earned Income Tax Credit
 - Phase-out of income tax increase
- Average growth rate reduced by more than half to 1.4%





Projections Made Against a Much Different Backdrop

	Annual Rates	
	Current Estimates <u>FY2010</u>	Fiscal Future Projections <u>FY09 - FY17</u>
Economic Projections		
Employment	-2%	-0.1%
Personal Income	1%	4.2%
Salaries and Wages	-1%	3.8%
State Tax Revenue Projections		
Income	-10%	3.25% (1.4% net)
Business	-2%	3%
Sales and Use	-3%	3%
Tobacco	-6%	-2.5%
State Education	-8%	4.25%
Revenue By Fund		
General	-6%	1.4%



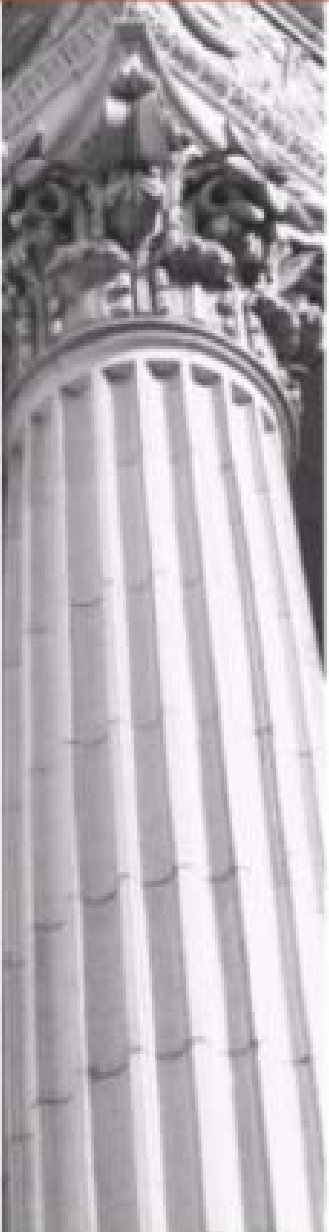


Spending Pressures

GF/GP analysis covers seven major areas

- Medical care
- Corrections
- Higher education
- Human services
- Mental health
- Revenue sharing with local governments
- Employee compensation and benefits

Assumption: Set It and Forget It



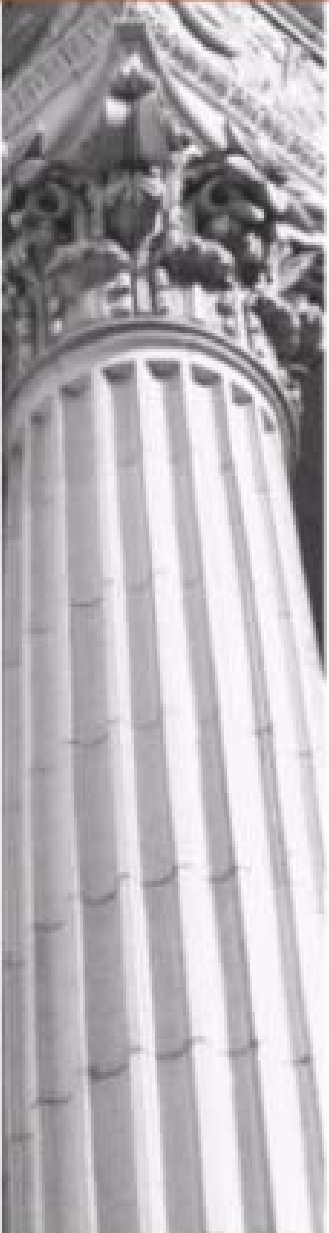


Medical Care

**Health care everywhere in budget
Growing faster than revenues**

Largest component in state budget

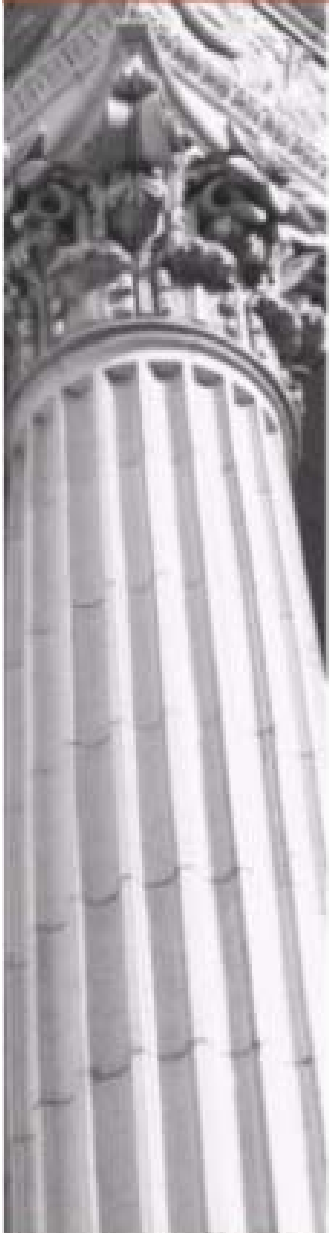
- Medicaid**
- Health insurance for school and state employees**
- Health insurance for school and state retirees**
- Prisoners**





Medicaid

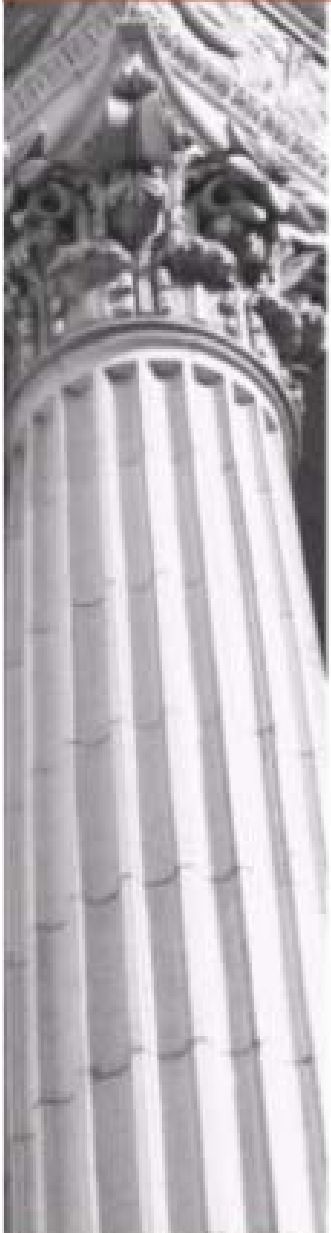
- **Medical care for 1 in 7 Michigan citizens**
- **Future total spending growth pressures 7.6% annually**
- **Some state revenues dedicated to Medicaid do not grow—Tobacco Settlement revenues, Cigarette Tax**
- **General Fund requirements grow faster than total Medicaid spending**
- **General Fund spending pressures increases average 10.1% annually**





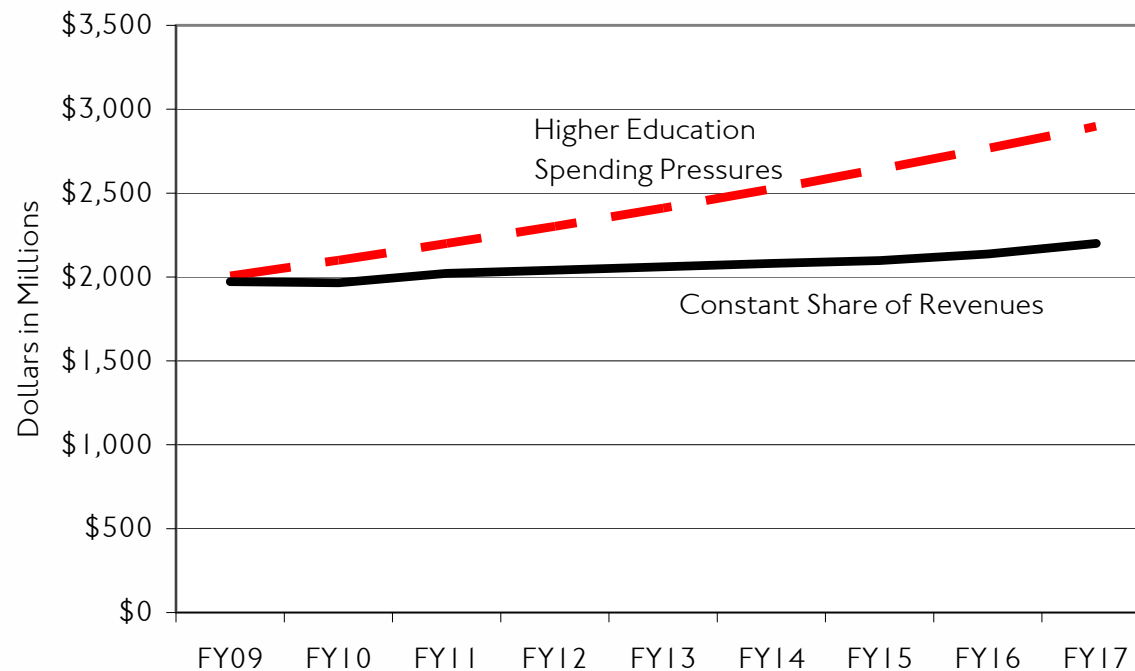
Higher Education

- Despite shrinking pop. cohort, more seeking higher education
- CC annual enrollment increases (2.6%)
- Primary spending pressures
 - Enrollment
 - Compensation (health and retirement)
- Revenue assumptions: constant MOE
 - If not, tuition and prop. tax must rise
- Spending pressures projected to rise 4.7% annually below GF revenue growth rate





State Pressures to Continue to Fund Higher Education

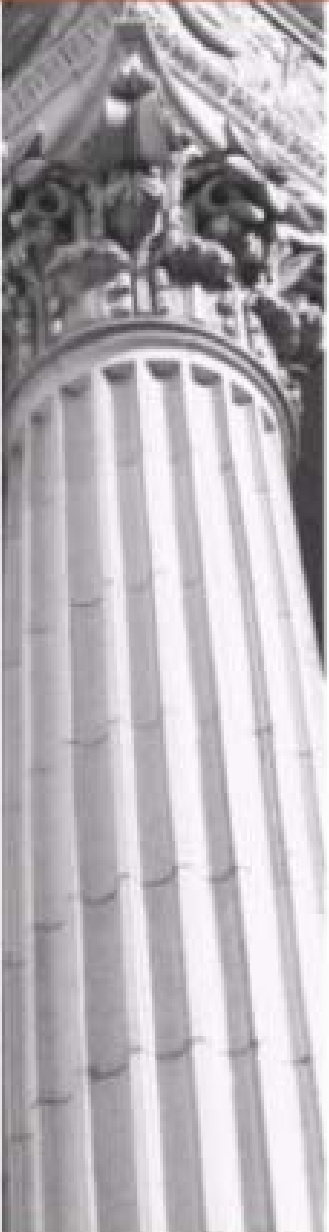


Source: CRC, *Michigan's Fiscal Future*



Update on Higher Education *Further Scaling Back of State Support*

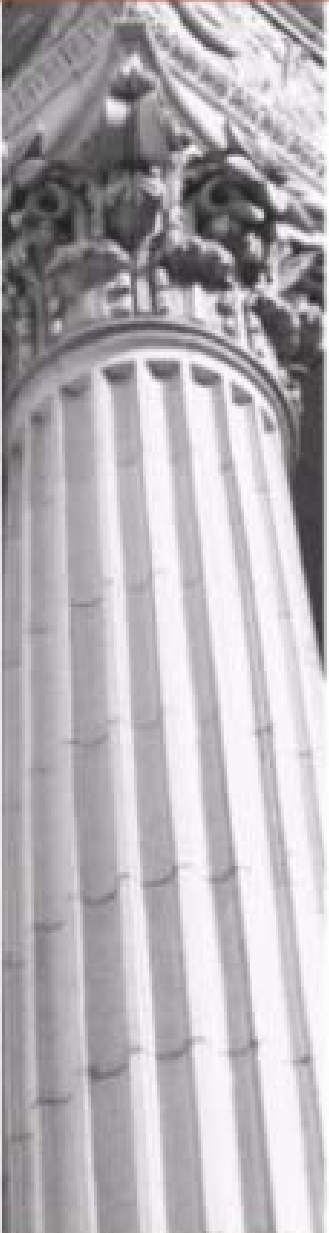
- Enrollments continue to climb, especially at CC level
- State operational support basically flat from FY09 to FY10
 - State share shrinking further (20 percent in FY09)
- Financial assistance programs reduced \$140 million (62 percent)
- Operational funding protected by federal stimulus in FY09 and FY10





Corrections

- Largest state-operated program
- 30% of state employees
- More than 50,000 prisoners
- 50+ prisons and camps
- \$31,000 per prisoner cost per year
- \$2 billion budget
- Incarceration rate 44% higher than Great Lakes neighbors-the result: Nearly \$600 million higher costs
- Spending pressures increasing more than 7% annually

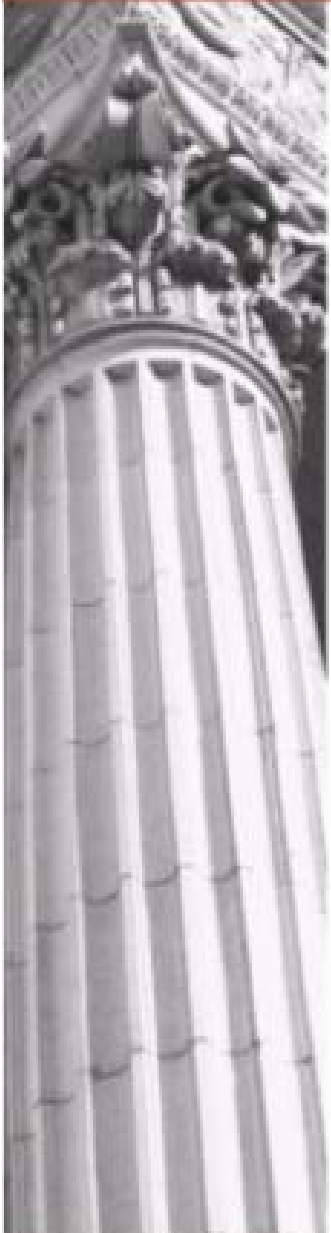




Update on Corrections

Scaling Back Prison Population

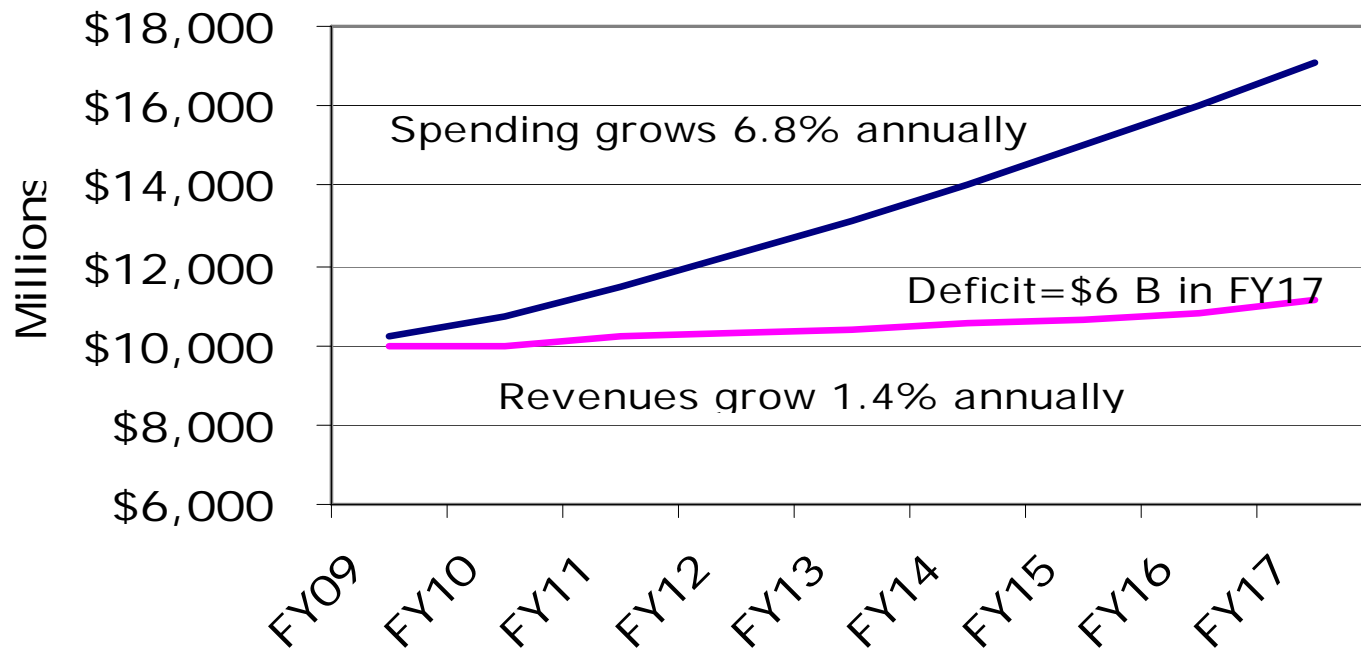
- Overall population down nearly 6,000 (45,000) since peak in '07
 - Addressing “back log” of those awaiting parole
 - Also, lower admissions and parole revocations
- Reduce facilities from 49 to 36
- Personnel reductions (656) to 15,180
- Still consumes \$2 billion or \$1 of every \$5





Problem is not Self-Correcting

General Fund Structural Deficit Projections
FY09 to FY17



Source: CRC, *Michigan's Fiscal Future*



Policy Options

- Reduce rate of spending pressure growth
- Increase revenue growth
- Bend the two curves so they meet





Revenues

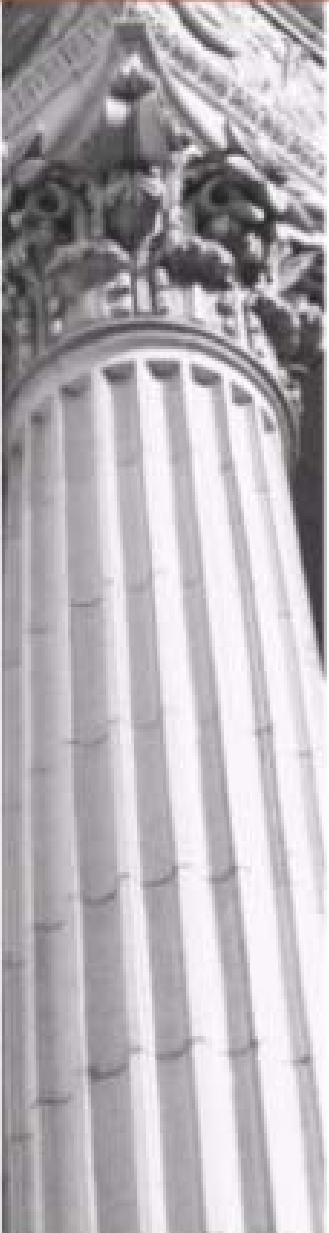
- Change system so revenues grow in line with economy and personal income
- Consider taxing services broadly
- Modify personal income tax by changing rate and exemptions—or—implement graduated income tax (Constitutional amendment required)
- Consider taxing pensions and other retirement income (area of greatest income growth in future)
- Reduce reliance on “sin” taxes





Spending Changes

- Reducing prison incarceration rate to the average of our neighbors over ten-years reduces General Fund annual spending pressure growth by 1.1%
- Holding health care cost increases to 5% per year reduces General Fund annual spending pressure growth by 1.8%

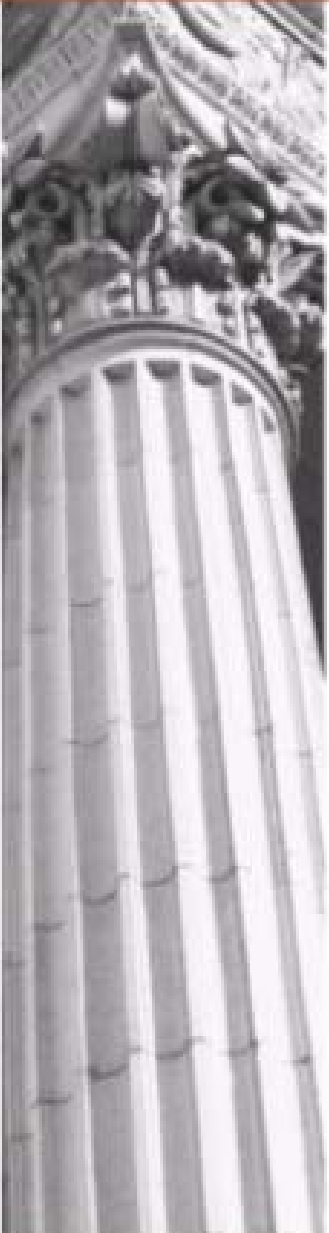




Achieving Structural Balance

- Revenue system changes alone will not be sufficient
- Policy changes reducing spending pressure growth will be required
- Health care is the principal target
- Politically-difficult decisions in most cases

Michigan is no longer a wealthy state and public service levels will have to be recalibrated





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